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Social Security and Privatization REALITY CHECK

Second in a Series

Private Account Supporters Try to Draw Attention from Benefit Cuts

Dear Colleague:

Private accounts, in and of themselves, do not contribute to solving the long-term financial challenges facing the Social Security system. David M. Walker, the Comptroller General of the United States confirmed that fact during his testimony before the Ways and Means Committee on March 9, 2005. Walker said the accounts by themselves will "exacerbate the solvency problem."

Walker did acknowledge that "the program faces a long-term deficit and that benefit reductions and /or revenue increases will be necessary to restore solvency." He also described one approach to benefit cuts. "Some proposals would reduce benefits relative to scheduled benefits by modifying the benefit formula", Walker explained. "For example, increasing the number of years used to calculate benefits or using price-indexing instead of wage-indexing would reduce the benefits individuals receive." He continued, "Since wages generally grow faster than prices, indexing earnings to prices rather than wages would reduce the measure of average lifetime earnings used in the formula – reducing benefits."

That is the secret that the Administration doesn't want the public to see. In a memo to supporters, Peter Wehner, White House Director of Strategic Initiatives, argued that they will never make any progress to "advance the idea of limited government without switching to price indexing the Social Security benefit formula." Price indexing is also a central component of Model 2 of the recommendations of the President's Commission to Strengthen Social Security, a proposal that the President himself has called a "good blueprint."

Price indexing is the wrong solution. It drastically cuts benefits for future retirees. According to the Congressional Budget Office report on Model 2, price indexing actually over corrects Social Security's financial shortfall. It would lead to benefit cuts that grow ever larger over time, locking future retirees into benefits based on today's standard of living.

I encourage you to read the attached column from Roll Call's recent special issue on Social Security to find out more on how price indexing would work. The President wants to let private accounts seize the day, but Democrats need to expose the truth about the benefit cuts.

Sincerely,

E Pomeroy

Earl Pomeroy
Member of Congress

ROLL CALL

Bush Not Sharing 'Dirty Little Secret'

March 4, 2005
By Rep. Earl Pomeroy,
Special to Roll Call

The plan to change Social Security's annual inflation adjustment is by far the most significant change being advanced in the debate over Social Security's future.

Even those closely following this debate may not be aware of this aspect of the proposal, obliquely referred to by President Bush in the State of the Union address and spelled out in greater detail in a leaked White House memo. In my view, it is the "dirty little secret" which, over time, arrives at the reformers' true objective: sharply reduced Social Security benefits for our children and grandchildren — even when the value of their new private accounts is considered.

The president's own advisers have clearly stated the case for this dramatic change to benefit calculations. In a White House memo leaked to reporters, dated Jan. 3, Peter Wehner, a senior adviser to the president, stated that "We simply cannot solve the Social Security problem with Personal Retirement Accounts alone. ... [They] are insufficient to that task."

"We're going to take a very close look at changing the way benefits are calculated," promised Wehner. "If we borrow $1-2 trillion to cover transition costs for personal savings accounts and make no changes to wage indexing, we will have borrowed trillions and will still confront more than $10 trillion in unfunded liabilities."

What Wehner is referring to is a proposal to scrap the Social Security program's "wage index" in favor of a "price index" to determine initial benefits for future Social Security recipients.

Since prices rise much more slowly than wages, the level of income replacement of an initial Social Security check would be greatly reduced over time under this change, resulting in significant cuts for the younger workers who will be tomorrow's retirees. Republicans prefer that retirement benefits be frozen at today's standard of living rather than allowing workers to maintain a productivity increase tied to wage growth.

The Center for Retirement Research at Boston College analyzed the effect that moving from a wage to price index would have on future retirees.

Their analysis shows that under a Social Security system indexed to prices, each generation would see successively deeper cuts in Social Security benefits.

Responding to the demographic reality that Americans are living longer does not require this type of drastic reduction in the lifetime income protections provided by Social Security.

For example, a 25-year-old medium wage earner, who is slated to receive more than $19,500 a year under the current system, would receive only $14,500 annually in retirement if a price index were implemented.

Participating in a private account would trigger additional reductions in the traditional Social

Security benefit, raising the bar to make up the $5,000 necessary to bring this worker's total retirement benefit up to what that worker would receive under the current benefit formula.

Indeed, there would be virtually no chance that a private account within Social Security could yield the $5,000 to cover the gap in benefits for this worker.

The cuts get even steeper for future generations, further reducing Social Security's protections. If our country were to switch to price indexing, my 9-year-old son would receive an initial Social Security check with 40 percent less replacement income in retirement than the amount received by today's retirees.

Make no mistake about it, dramatic cuts of this magnitude would result in millions of future seniors living in poverty. Currently in my home state of North Dakota, the average monthly Social Security check is around $834 a month.

If we adjust this modest amount to reflect the level of benefit cuts that would apply to a young worker if a switch to price indexing occurred throughout the employee's career, then the average check today would be only $470 a month — even when gains from private accounts are included. This kind of reduction would mean that the 38,000 seniors in North Dakota who have no other income outside of Social Security would receive only $5,124 a year — putting them $3,100 below the poverty line.

Before the 1970s, changes to Social Security benefits depended on Congress enacting changes to keep payment up to date. In 1986, the United Kingdom decided to use price indexing for Britain's Basic State Pension and now 25 years later the basic pension has lost more than half its value. The result has pushed more British retirees into means-tested benefits and suggests that adopting such a change for Social Security would result in seniors demanding periodic adjustments from Congress once again.

When Treasury Secretary John Snow testified before the Ways and Means Committee last month, he encouraged Congress to act with honesty and transparency when addressing the challenges facing Social Security.

The truth is that when we have an honest look at the facts, it becomes transparent what the administration has in store for Social Security: a dramatic overhaul that causes great harm to future generations of retirees. Social Security is a promise that has been kept between generations, and we must not make this successful program weaker for our children.

Rep. Earl Pomeroy (D-N.D.) is a member of the Ways and Means subcommittee on Social Security.